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SUBJECT: BHP PREVIEWS SCUTTLING OF CHINESE INVESTMENT

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Summary -----

11. (C/NF) According to its CEO Marius Kloppers, BHP Billiton played a role in quashing Chinalco's bid to invest \$19.5 billion in Rio Tinto. This meeting took place one day prior to Rio Tinto's decision to walk away from the Chinalco deal (septel from Embassy). BHP, however, still has its eye on acquiring some of Rio's assets and believes the stars may be aligning. Kloppers says Australia does not have a clear "China policy," but appears to have drawn a line in the sand against foreign ownership of the largest Australian firms. BHP Billiton and China will still be bedfellows for the foreseeable future, but the union is at times tumultuous.
End Summary.

Rio Tinto Still in BHP's Crosshairs -----

12. (C/NF) During a June 4 meeting in his Melbourne headquarters, BHP Billiton CEO Marius Kloppers told Consul General that his firm had taken steps to derail Chinese state-owned Chinalco's \$US 19.5 (\$A 23.9) billion investment in Rio Tinto. (Note: Various open source reports have described BHP's vigorous lobbying efforts in Canberra against the Chinalco/Rio Tinto deal. End note.) Hours after the meeting, press reports indicated that Rio Tinto caved into shareholder concerns about Chinese influence and walked away from the deal (see septel from Embassy for more detail). BHP Billiton, however, still has its eye on acquiring choice Rio Tinto assets and now maintains significantly higher cash reserves than it did last fall when the acquisition of Rio Tinto fell through. In addition, South-African born Kloppers who describes himself as only nominally Australian, believes that Rio Tinto's new chairman, Jan du Plessis (also a South African) is more amenable to a potential deal with BHP Billiton. Finally, he attributed the failure of the last attempt to financing woes and hinted that the environment today would be more conducive to an acquisition of Rio Tinto (and its \$US 38 billion in debt).

13. (C/NF) Despite Chinalco's late May announcement that it would restructure its investment deal with Rio Tinto to allay GOA concerns about the perceived Chinese influence on Rio Tinto, Kloppers confidently predicted on June 4 that the deal would fall through. Clearly frustrated, Kloppers noted that doing business in Melbourne is like "playing poker when everyone can see your cards." He complained that Chinese and industrial (Rio Tinto) surveillance is abundant and went so far as to ask Consul General several times about his insights

into Chinese intentions, offering to trade confidences.
Kloppers even hinted about privacy concerns vis-a-vis the GOA.

Does Australia Have a China Policy?

¶4. (C/NF) Similar to what we have heard from other observers, Kloppers does not believe that Australia has a well defined China policy. He believes that Australia would like to build up trade with China, but there is a "real fear" of the Chinese government. "Australia does not want to become an open pit in the southernmost province of China," he added. Kloppers thinks the GOA is drawing a line in the sand to keep Chinese-state owned firms from owning the larger mining companies such as Rio Tinto, BHP Billiton and Woodside. He added that the GOA would be relieved if they did not have to turn down the Chinalco/Rio Tinto deal. He also believes Chinese state-owned firms would encounter heavy resistance should they make overtures at Australia's telecommunications and banking giants.

The Future with China

¶5. (C/NF) While he acknowledged there is potential to do more business with India, particularly on energy-sources, Kloppers was focused on China. Approximately 20 percent of BHP's book of business is dependent on China; this is up from only 3.6 percent in 2001. India presently accounts for 4.5 percent of BHP's business. He acknowledged some difficulty in working with the Chinese, but he appeared optimistic that BHP would eventually get their Chinese customers to move away from contract based pricing on iron ore and inch toward a system where the market sets prices. Already, there is support for this among Chinese factory managers who "routinely" find

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exceptions to marching orders on pricing handed down by Beijing. Kloppers believes the Chinese will build 200-300 nuclear power plants over the next 10-15 years and that this increase would be necessary to justify expanding the Olympic Dam uranium mine in South Australia to full capacity.

Bearish Thoughts on the Australian Economy

¶6. (C/NF) Kloppers said the Australian stock market is due very soon for a correction. He does not see improvements in real world economic conditions. Recent rallies in global stock prices have been buoyed by "artificial optimism." Debt loads are still high; they have only been shifted off of corporate balance sheets onto government ones. Kloppers' baseline assumption is that the Australian and global economies will recover, albeit slowly. He rejected the idea of a "V-shaped" recession and believes that it will instead look more like an "L." Kloppers described Australia's Carbon Pollution Reduction Scheme (CPRS) as a "tax on exports" and said that the more reasonable approach to the problem of reducing emissions was a multi-faceted solution including solar, reforestation and a re-examination of nuclear power.

Comment

¶7. (C/NF) Kloppers appeared to be an uneasy bedfellow with the Chinese. He recognizes the need to remain cozy with one of his largest customers, but he is frustrated by Chinese practices such as rallying customers into trust-like blocs, forcing him to write one-sided options, and regularly "squeezing through contract loopholes." On the other hand, he was upbeat because he clearly sees an opportunity to purchase some of Rio Tinto's more lucrative assets even if they decide to not pursue an outright purchase (septel from Embassy). BHP sees a substantial opportunity with Chinalco out of the way and Sinophobia waxing among Rio's shareholders and among many Australians.

THURSTON